

Anticipated acquisition by British Telecommunications plc of ESPN Global Limited

ME/6004/13

The OFT's decision on reference under section 33(1) given on 5 July 2013. Full text of decision published 18 July 2013.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **British Telecommunications plc (BT)** is an international provider of telecommunications solutions and IT services in the UK and worldwide. BT's UK turnover for the financial year ending March 2012 was £14.9 billion.
2. **ESPN Global Limited (ESPN)** is a private limited company limited by shares incorporated under the laws of the Republic of Ireland. ESPN is wholly owned by ESPN, Inc. ESPN broadcasts channels dedicated to sports coverage. At the time of the transaction ESPN operated three sports channels in the UK, namely ESPN, ESPN America and ESPN classic. ESPN's UK turnover for the financial year ending 30 September 2012 was £131 million.

TRANSACTION

3. The parties signed a Share Purchase Agreement on 25 February 2013. The transaction is due to complete on or around 31 July 2013. BT is due to pay a consideration of [] million, with adjustments, for the entire issued share capital of ESPN. The assets being transferred include the rights and content associated with two of ESPN's channels (namely ESPN and ESPN America), but not the third channel (namely ESPN Classic).¹

¹ ESPN classic is planned to cease to broadcast before completion of the transaction.

4. The administrative deadline for OFT to make its decision is Tuesday 9 July 2013.

JURISDICTION

5. As a result of the transaction BT and ESPN will cease to be distinct.
6. The UK turnover of ESPN in the financial year ending 30 September 2012 was £131 million. Consequently, the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied.
7. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

COUNTERFACTUAL

8. The OFT assesses the competitive effects of a merger by comparing the prospects for competition with the merger against the competitive situation absent the merger. The description of the latter, the counterfactual, is affected by the extent to which events or circumstances are foreseeable. In practice, the OFT generally adopts the prevailing conditions of competition as the counterfactual against which to assess a merger. The parties submitted that, absent the acquisition, ESPN would have exited the market.
9. The OFT therefore considered whether, based on the evidence available, the acquisition should be measured against an alternative counterfactual. In particular:
 - whether ESPN would have inevitably exited the UK
 - whether there would have been an alternative purchaser for ESPN, or its assets, and whether this would produce a better outcome for competition than ESPN being acquired by BT, and
 - what would have happened to the sales of ESPN in the event of its exit.²
10. The OFT considered each of the criteria below.

² Merger Assessment Guidelines, paragraph 4.3.10.

Would ESPN have inevitably exited the UK?

11. ESPN submitted a number of documents as evidence that it had taken a strategic decision to exit the UK. In particular, presentations going back as far as August 2011 illustrate the poor financial performance of ESPN and demonstrate that ESPN was considering, even at that time, a number of different options for its business going forward. In Summer 2011 ESPN carried out a strategic review of its UK and European sports channels – Project EMEA. The conclusion of the Project EMEA was that if ESPN could not turn around the business then it should 'map out key dates to achieve an optimal economic shutdown scenario.'³
12. In February 2012, as part of ESPN preparing to bid for packages in the auction of English FA Premier League (FAPL) rights for 2013/14 – 2015/16, ESPN evaluated a number of bidding options and concluded that the best would be to win one package.⁴ The document also considers a number of options if ESPN did not win any FAPL rights. It noted that, 'if ESPN is not deemed to hold a strategic position by Sky it could continue premium retailing; however, preliminary analysis indicates that this is not a viable business model.'⁵
13. In June 2012, ESPN was informed that it had been unsuccessful in winning any packages of rights at the FAPL auction.
14. ESPN's UK channels' business planning for Financial Year 2012/13 presentation states that 'we have a firm direction [from ESPN's parent company] to exit the UK/pan-European TV business from August 2013 (if not before in a sale scenario).' The documents sets out three possibilities: (i) sale of business, (ii) sale of assets, (iii) sale of rights only, with the sale of the business noted as the best outcome. ESPN was seeking to achieve a 'premium for the UK channels business as a going concern', however, if this was not possible, ESPN planned to 'mitigate shutdown costs of the UK channels business at the end of FY13.'⁶
15. ESPN's later internal documents indicate that it would have exited the UK absent the merger at, or towards, the end of July 2013 and had

³ Project EMEA, preliminary draft, 2 August 2011.

⁴ ESPN held one FAPL rights package for 2010/11 – 2012/13.

⁵ EPL Auction Briefing, February 1012

⁶ ESPN's financial year for 2013 ends at 31 September 2013.

investigated a number of options to realise the maximum value for its assets. ESPN determined that maximum value would be achieved through a sale of the business. If this could not be achieved, ESPN would still have exited the UK, minimising the shutdown costs through a sale of its existing rights. The OFT considers that, on the available evidence, ESPN would have exited the market, the OFT has therefore examined the other limbs of its exiting firm criteria.

Alternative Purchasers

16. When considering the prospects for an alternative buyer for the firm or its assets, the OFT will look at available evidence supporting any claims that the merger under consideration was the only possible merger (that is, that there was genuinely only one possible purchaser for the firm or its assets). The OFT will take into account the prospects of alternative offers for the business above liquidation value. The possible unwillingness of alternative purchasers to pay the seller the asking purchase price would not rule out a counterfactual in which there is a merger with an alternative purchaser.⁷
17. ESPN have indicated that it did not widely market the sale of ESPN's UK channels and that it only held substantive negotiations with British Sky Broadcasting Limited (BSkyB⁸) and BT.
18. In August 2012, ESPN's internal documents⁹ show that it considered that other broadcasters such as Perform, Al Jazeera, and Eurosport might be interested in purchasing some, or all, of the UK business, but that their level of interest had not been determined and they were not approached by ESPN. ESPN believed that both BSkyB and BT would clearly be interested in a potential purchase and believed that it could achieve best value by approaching these businesses rather than exploring interest from other broadcasters.
19. ESPN entered negotiations with BT and BSkyB in late 2012. Although the purchase price discussed at that time was around [] internal ESPN documents show that a sale of the business, at any price, would achieve a

⁷ OFT CC Joint Merger Assessment Guidelines, paragraph 4.3.17

⁸ Note: 'BSkyB' has also been referred to as 'Sky' in a number of documents received by the OFT. BSkyB broadcasts, amongst other channels, Sky Sports 1 and Sky Sports 2.

⁹ UK channels business, planning for FY13, 10 August 2012

significantly greater return than a shutdown of the business.^{10,11} This would indicate that ESPN may have been willing to complete a sale to any willing buyer for a significantly lower amount.

20. There is some evidence that there were other buyers who may have been interested in purchasing ESPN. Whilst the level of these parties interest in purchasing ESPN has not been established, the parties have failed to provide sufficiently compelling evidence that other parties would not have been interested and that no alternative purchaser outside of BT and BSkyB existed.

Conclusion on whether exiting firm scenario is met

21. On the evidence available, it appears that ESPN had taken the decision to exit the market, however, the evidence is not compelling that ESPN could not have been sold to a less anti-competitive purchaser. Given the OFT does not consider that the second criteria of the exiting firm test is met it has not found it necessary to go on to consider what would have happened to the sales of ESPN in the event of its exit.

Conclusion on counterfactual

22. The OFT will assess the transaction against a counterfactual of BT operating a sports channel from August 2013 and ESPN (or another independent company) continuing to operate the ESPN sports channels post August 2013. For the avoidance of doubt, the counterfactual is ESPN in its current state, that is, having been unsuccessful in bidding for any live FAPL broadcast package for the 2013/14 to 2015/16 seasons.

MARKET DEFINITION

23. In this case, the OFT considered whether the parties overlap in the following areas:
 - the acquisition of sports rights from sports content holders, and
 - the supply of premium sports channels to end viewers.

¹⁰ ESPN's internal papers show that a stock sale would allow for a significant tax benefit on capital losses, []

¹¹ Whilst a shutdown of the business was likely to be costly, ESPN calculated that this option would be preferable to continuing to operate in the UK.

Acquisition of Sports Rights

24. The parties overlap in the acquisition of sports rights from sports content holders.¹² Sports rights are commonly either sold through auctions or individual negotiations with sports rights holders. Competition takes place at the point at which the sports right is auctioned. In the case of televised sports content, any company operating a television broadcasting channel would be free to bid for sports rights.¹³ As discussed above, any sports broadcaster¹⁴ would need to actively bid for sports rights to, at a minimum, maintain its' current, or similar, content. BT has been active in the sports rights market since contesting (and winning) a package of rights at the FAPL auction in June 2012. Competition for premium sports rights, such as live FAPL broadcasts, is likely to be limited to those operating a Pay TV sports channel,¹⁵ whereas, other sports rights are sold to a wider range of broadcasters.
25. The OFT will therefore consider how the merger impacts competition between TV channels in acquiring sports rights and, in particular, whether there are any additional impacts in competition for premium sports rights.

Supply of premium sports channels to end viewers

26. Both parties own a sports channel which is supplied, either by retail or wholesale means to end users. Ofcom considered market definition in relation to sports channels in the Pay TV statement.¹⁶
27. In the Pay TV Statement, Ofcom concluded that 'the relevant market comprises the provision in the UK of packages including Sky Sports 1 and/or Sky Sports 2 and/or ESPN. [Ofcom] consider that coverage of football, cricket, golf, tennis, rugby union and rugby league on Free to Air (FTA) channels¹⁷ is at most a moderate substitute for such packages,

¹² Sports rights confer upon the owner the right to broadcast specific (often exclusive) sports content for a set period of time, typically three to five years.

¹³ By way of example, currently ITV has a licence to broadcast live UEFA Champions League football and the BBC has a licence to broadcast live Formula 1 motor racing.

¹⁴ Including ESPN - or another independent company - continuing to operate the ESPN sports channels post August 2013 (see paragraph 25)

¹⁵ Dedicated sports channels which viewers pay to subscribe to.

¹⁶ Ofcom Pay TV statement

http://stakeholders.ofcom.org.uk/consultations/third_paytv/statement

¹⁷ Channels that are free for viewers to access (ignoring set-up and TV licence costs)

rather than a close substitute. Coverage of other sports on FTA channels and coverage of non-sports content are distant substitutes.¹⁸

28. The OFT did not receive any evidence that Ofcom's finding of a premium (subscription) sports market, with some limited constraint from outside this market is inappropriate.

Conclusion

29. The OFT has not found it necessary to conclude on market definition. However, for the purposes of the competition assessment, the OFT has considered the potential effects of the proposed transaction in the following markets:

- the acquisition of sports rights, and
- the supply of premium sports channels to end users.

Geographic scope

30. The OFT did not need to conclude on the geographic scope. However, for the purpose of the competition assessment, the OFT investigated the market at a UK level as sports rights normally cover a single country and as such it is unlikely that the geographic scope is wider or narrower than the UK. Further, Sports channels need to carry content which appeals to viewers, and as such is likely to be of a UK nature. The channel will also need to be broadcast in English, as opposed to European channels which are broadcast in the relevant national language.¹⁹

HORIZONTAL ISSUES

Strength of ESPN

31. As explained above, ESPN had lost the rights to broadcast live FAPL content from 31 July 2013. The parties submitted survey information which indicated that although FAPL was ESPN's most important sports right, it retained other attractive properties, particularly the FA Cup (in England and Wales) and SPL (in Scotland). However, these surveys were

¹⁸ Ofcom Pay TV Statement paragraph 5.336

¹⁹ For instance, Eurosport is active in a number of countries in Europe, but generally has a different channel targeted at each major country.

carried out whilst ESPN held its current FAPL contract and are not indicative of the value that viewers would place on ESPN without any live FAPL content. It is clear that ESPN will be a less attractive proposition to viewers from August 2013, albeit that it still retained a number of sports rights which are of value to viewers.

Bidding for Sports Rights

32. BT has been active in the sports rights market since contesting (and winning) a package of rights at the FAPL auction in June 2012. ESPN was one of a number of other bidders who showed an interest in the FAPL auction to broadcast live FAPL content in the UK.²⁰ At the FAPL auction, BT was successful in acquiring two packages of sports rights; ESPN were not successful in winning any of the live UK rights packages auctioned.²¹ Overall, the entry of BT into this round of bidding resulted significant rights inflation, in that the FAPL raised significantly more revenue for the rights for the 2013/14 to 2015/16 seasons than they had raised for the 2010/11 to 2012/13 seasons.
33. ESPN submitted that after losing the Premier League rights, it did not bid for any new sports rights, it only undertook to renew existing rights, whilst it reviewed its position. ESPN further submitted that, following its decision to exit European Sports Broadcasting in August 2012, it did not enter any sports rights auctions. This is supported by the bidding data submitted by ESPN which shows that ESPN only bid for two sports rights in competition with BT (other than FAPL) prior to the decision to exit.²²
34. Third parties indicated that there are a number of firms active in the acquisition of sports rights, with significant variation in the set of potential bidders, depending on the attractiveness of the rights package. In particular, BSkyB, BT, ESPN, Eurosport, ITV, Channel 5 and BBC were named as actual or potential bidders, along with other specialist firms or those not currently active in the UK.

²⁰ www.premierleague.com/en-gb/news/news/2012-13/jun/premier-league-announces-audio-visual-rights.html

²¹ The rights auctioned in June 2012 were the rights for FAPL in the 2013/14 to 2015/16 seasons. ESPN's current FAPL rights package runs up to the end of the 2012/13 season (31 July 2013)

²² German Bundesliga football and French Rugby

35. Sports rights holders who responded to the OFT did not express any concern about the merger, even though some noted that the merger may represent a reduction in the number of bidders for some sports rights from three to two.²³ However, the affected rights are reported to be related to coverage of events in less popular sports which will rarely be of interest to non-specialist sports channels. Brokers, who are active in marketing such events, reported that these events are rarely put out to tender, but are more often sold directly to channel operators through direct negotiations with the broker. These brokers noted that ESPN was not a strong competitor to either BSkyB or BT and that BT's entry into the market had stimulated competition between BSkyB and BT. Hence, ESPN imposed only a limited competitive constraint on BSkyB and BT.²⁴

Supply of content to end viewers

36. The parties argue that there is no overlap between BT and ESPN,²⁵ in the supply of content to end viewers. However, the OFT has not distinguished between wholesale and retail supply in order to get content to end viewers.

37. The OFT's investigation has identified a number of competitors who will continue to provide a competitive constraint on the merged entity after the merger, including BSkyB, Eurosport, ITV, BBC, Channel 4 and Channel 5.

38. By way of shares of supply, the latest Ofcom Pay TV Statement indicated that BSkyB has a market share of above 50 per cent.²⁶ One third party provided information on the average audience between May 2012 and April 2013. This indicates that ESPN's market share is between three and seven per cent.²⁷

39. BT's internal documents indicate that although it may have targeted ESPN customers to help to grow its subscriber base, other internal documents

²³ Third parties indicated that this is more likely to be the case for sports rights with more limited appeal as terrestrial broadcasters would not be interested in acquiring them due to their limited appeal.

²⁴ BSkyB is recognised as the dominant player in the UK sports broadcasting market.

²⁵ As (i) ESPN had decided to withdraw from the market by August 2013, and the BT Sports channel does not launch until then; and (ii) ESPN do not operate a platform, preferring to wholesale their channel to other operators whilst BT plan to retail BT Sports to BT's own subscribers and self retail to Sky's subscribers BT Sports.

²⁶ Pay TV statement, paragraph 5.8

²⁷ As discussed at paragraph 31 ESPN will be seen as a less attractive offer by viewers following the loss of the FAPL contract. Hence ESPN's share is likely to be lower in the counterfactual.

indicate that BT entered the sports broadcasting market with the primary intention of targeting Sky Sports customers.

40. Some third parties indicated that the merger represents a reduction in suppliers from three to two (BT and BSkyB) in the supply of pay TV premium sports channels to end viewers, though no third party articulated substantive unilateral competition concerns. A number of third parties have also indicated that the merger may be pro-competitive as it strengthens BT's offering against Sky Sports, which may allow it to compete more effectively.

Barriers to entry and expansion

41. Given the outcome of its competition assessment the OFT has not found it necessary to conclude on barriers to entry.

VERTICAL ISSUES

42. The OFT received representations from a number of third parties relating to vertical aspects of the merger. Broadly speaking these fall into one of two categories: input foreclosure and margin squeeze.
43. The OFT typically frames its analysis of non-horizontal mergers by reference to:
- (i). the ability of the merged firm to harm rivals, typically through an increase in price or a withholding of supply
 - (ii). the incentive of the merged firm to do so, and
 - (iii). whether the effect of any action of the merged firm would be sufficient to reduce competition in the effected market to the extent that it gives rise to a SLC.²⁸
44. In this case, it is important to note that Ofcom is conducting an ongoing investigation into an alleged abuse of dominance by BT in the form of a margin squeeze in relation to superfast broadband.²⁹

²⁸ OFT CC Joint Merger Assessment Guidelines, paragraph 5.6.6 onwards

²⁹ Complaint from TalkTalk Telecom Group plc against BT Group plc about alleged margin squeeze in superfast broadband pricing - http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01103

Input Foreclosure

45. The theory of harm in relation to input foreclosure explores whether BT would be able to harm rival platform TV operators, such as BSkyB, Virgin Media, or TalkTalk, by refusing to supply them with ESPN's content. In order for this refusal to supply to result in harm to the rivals, ESPN must be sufficiently important that a significant proportion of customers would switch away from rival operators to BT if ESPN were only available through BT's platform.
46. The parties overlap in the provision of premium subscription sports channels, in which they have a market share of less than 25 per cent. BSkyB is the most significant broadcaster in the sector, with a market share of over 50 per cent.³⁰
47. A consumer's choice of subscription TV platform(s) will depend on a number of factors, such as price and range of service, with subscription TV also frequently included in bundles alongside broadband and fixed line telephony services. Consumer choice will be driven by a number of factors, and although third parties have provided some evidence to show that their customers value ESPN, this is not compelling evidence that consumers would be willing to switch to such an extent that the broadcast retailer would be foreclosed if ESPN were not available.
48. Competitors have ([endnote 1](#)) provided the OFT with evidence that BT were insisting on a minimum revenue guarantee for BT Sports channels - including ESPN content - which is many times higher than the current minimum revenue guarantee under contracts for the ESPN channels.
49. The OFT requested information from third parties on the number of their customers who currently subscribe to ESPN. The responses received from competitors indicated that there are only a small proportion of customers who purchase ESPN as a stand-alone package (less than one per cent of customers). Significantly more consumers purchase ESPN as part of a bundle, but take-up by customers would appear to be dependent on the make-up of the bundle with bundles including ESPN being taken up by

³⁰ The wholesale must-offer – Pay TV Statement

between 1.1 per cent and 56 per cent of customers.³¹ It would appear that ESPN, in and of itself, is not seen as an attractive package by customers and will be viewed as being even less attractive following the loss of the FAPL content (see paragraph 30).

50. Given BT has some FAPL broadcasting rights from 2013/14 to 2015/16 and given the low proportion of customers who subscribe to ESPN alone, the OFT considers that it is likely that it is the FAPL broadcasting rights, not the remaining rights of ESPN, which may have strengthened BT's ability and/or incentive with respect to input foreclosure (if indeed that is the case). It is not the merger which has strengthened BT's ability and/or incentive in this regard. Therefore, the OFT does not believe that the effect of this merger will be to materially strengthen BT's ability to foreclose downstream broadcasting rivals.

Margin Squeeze

51. Ofcom is conducting an ongoing investigation into an alleged abuse of dominance by BT in the form of a margin squeeze in relation to superfast broadband, following a complaint from TalkTalk.³²
52. In terms of any effect arising from this merger, the OFT considers that its analysis above (paragraphs 49 and 50) are applicable. That is, the merger itself has not materially strengthened BT's position in the marketplace and therefore the OFT does not consider that this area of third party concern is directly related to the merger.

THIRD PARTY VIEWS

53. Third party views have been noted in the above sections on market definition and substantive assessment. However, the OFT noted that the majority of suppliers were either unconcerned, or, believed that sufficient choice would remain post merger to ensure that competition remained healthy. A number of sports rights owners indicated that the transaction will create a stronger competitor to Sky Sports

³¹ The wide range of take-up is reflective of the take-up of the bundles that include ESPN. The more popular bundles include Sky Sports 1 and 2, the less popular ones do not.

³² Complaint from TalkTalk Telecom Group plc against BT Group plc about alleged margin squeeze in superfast broadband pricing - http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01103/

ASSESSMENT

54. For the purposes of the competition assessment, the OFT investigated the following markets:
- acquisition of sports rights
 - supply of premium sports channels to end users.
55. The OFT assessed the transaction against a counterfactual of ESPN's UK channels continuing to operate absent the merger, whilst acknowledging that the strength of ESPN's competitive constraint would diminish due to the loss of FAPL rights.
56. BT is a new entrant into the sports broadcasting market and would have entered this market, absent the transaction, due to the rights they have acquired pre-merger.
57. Bidding data supplied by the parties show that they are not each other's closest competitors in the acquisition of sports rights, with BT contesting major rights with BSkyB, leading to significant rights inflation since they entered the market. Third parties have indicated that there are a number of other firms active in the acquisition of sports rights, although some are only interested in a limited number of rights.
58. In 2012/13, ESPN had a share of supply of premium (subscription) sports channels of between three and seven per cent, Sky Sports having share of over 50 per cent and BT not active. The transaction will serve to move ESPN's share to the newly established BT and enhance its content, with third parties indicating that it will create a stronger competitor to Sky Sports.
59. Third parties have raised a number of vertical concerns around the merger. The OFT has considered these concerns carefully and concluded that the addition of ESPN to the BT Sports channels will not materially strengthen BT's ability and/or incentive to engage in input foreclosure or margin squeeze and therefore these third party concerns are not merger specific in nature.

60. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

61. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

ENDNOTES

1. 'Competitors have' should read as 'One competitor has'